

HOUSE BILL REPORT

E2SSB 5773

As Reported by House Committee On:
Commerce & Labor

Title: An act relating to protecting homeowners who hire contractors to remodel or build their homes.

Brief Description: Protecting homeowners who hire contractors to remodel or build their homes.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Fraser, Fairley, Kohl-Welles, Rockefeller, Kline and Pridemore).

Brief History:

Committee Activity:

Commerce & Labor: 3/28/05, 3/31/05 [DPA].

**Brief Summary of Engrossed Second Substitute Bill
(As Amended by House Committee)**

- Requires residential contractors to act in the best interests of homeowners as to funds paid by homeowners for labor or materials.
- Makes residential contractors personally liable if they violate fiduciary duties owed to homeowners, and fail to show that funds were paid to suppliers and/or subcontractors.
- Requires courts to find that lien claimants made reasonable efforts to recover funds not paid from residential contractors before ordering foreclosure.
- Requires permitting agencies to require homeowners to acknowledge receipt of certain information about liens before issuing building permits.
- Establishes a joint legislative task force to review construction lien and contractor registration laws.

HOUSE COMMITTEE ON COMMERCE & LABOR

Majority Report: Do pass as amended. Signed by 4 members: Representatives Conway, Chair; Wood, Vice Chair; Hudgins and McCoy.

Minority Report: Do not pass. Signed by 3 members: Representatives Condotta, Ranking Minority Member; Sump, Assistant Ranking Minority Member; and Crouse.

Staff: Jill Reinmuth (786-7134).

Background:

Washington law creates a mechanics' and materialmen's lien to benefit any person who furnishes labor or materials for a private construction project. If a subcontractor or supplier does not receive payment for labor or materials, the lien procedures may be used to recover the payment. The owner's property may be subject to a lien by a subcontractor or supplier even if the owner has paid the prime contractor in full for the construction project. To avoid a sale of the property, an owner may be forced to pay for the work twice.

Definitions

Various terms are defined in lien laws, including "contract price," but not "prime residential contractor," "residential subcontractor," or "residential homeowner." "Contract price" is defined as the amount agreed upon by the parties, or if no amount is agreed upon, the customary and reasonable charge.

Lien Process

To claim a lien, the potential lien claimant must provide notice of the potential lien to the owner within required time periods, file the lien within 90 days after work has ceased on the project, and initiate a lien action within eight months of filing the lien. The notice of claim of lien must specify the principal amount of the lien. The person who signs the notice of claim of lien must state that they have read the notice of claim, and believe it to be true and correct.

Foreclosure

If a lien has been properly created and is not discharged by paying the claim, then the property may be sold to satisfy the lien.

Informational Materials

Real property lenders and construction contractors are required to give informational materials on construction lien laws and available safeguards against lien claims to their customers. Lenders must give the document to persons who obtain loans to be used for construction or remodeling. Contractors must provide the document to certain customers, including those who contract for the construction or remodeling of four or fewer residential units when the price is \$1,000 or more.

The Department of Labor and Industries (Department) is required to prepare the master documents for the informational materials. The documents must include methods of protection that a consumer might use and sources of further information, including the Department and the Office of the Attorney General.

Summary of Amended Bill:

Provisions establishing fiduciary duties and personal liability for residential contractors are added. Provisions governing liens, foreclosure, and building permits are modified. A joint legislative task force on construction lien and contractor registration laws is established.

Definitions

The definition of "contract price" is modified to specify that the "contract price" may include overhead and profit, but not amounts payable in the event of nonpayment or late payment.

A definition of "prime residential contractor" is added. A "prime residential contractor" is: (1) a prime contractor engaged in the business of constructing or remodeling a single-family residence of a homeowner; and (2) the prime contractor's principals, partners, officers, directors, members, vice principals, and agents with executive, managerial, supervisory, physical, or actual control over funds received by the prime residential contractor from homeowners. "Residential subcontractor" is defined in a similar manner.

A definition of "residential homeowner" is also added. For most purposes of the lien laws, "residential homeowner" has the same meaning as it does for purposes of the contractor registration laws. However, for purposes of the fiduciary duties and personal liability of the prime residential contractor, "residential homeowner" also means a person who has entered into a contract with a contractor, builder, or developer to purchase and occupy a single-family residence at the completion of improvements to the residence or an appurtenant garage.

Fiduciary Duties

Prime residential contractors must:

- act in the best interests of homeowners in the receipt, management, and disbursement of amounts paid by a homeowner to the prime residential contractor for labor or materials supplied by a supplier or subcontractor;
- defend homeowners against claims of liens for which the contractor was paid by the homeowner;
- maintain accounting records (but not separate accounts) to identify moneys received from homeowners and paid to suppliers and subcontractors; and
- not use amounts paid by a homeowner for other purposes unless either the amounts owed to suppliers and subcontractors have been paid in full or the prime residential contractor provides written notice of its intent not to fully pay certain suppliers and subcontractors and its reasons for not doing so.

Similar provisions apply to residential subcontractors.

Personal Liability

Prime residential contractors who violate the fiduciary duties they owe to residential homeowners are personally liable for the full amount of any liens if:

- the prime residential contractor fails to show that funds paid by the homeowner to the contractor were actually paid to suppliers or subcontractors;
- the prime residential contractor had knowledge of such use of funds (unless the prime residential contractor shows that he or she actually did not know); and
- the supplier or subcontractor records a notice of claim of lien against the prime residential contractor or the homeowner.

Similar provisions apply to residential subcontractors.

Lien Process

The notice of claim of lien must specify the principal amount of the lien, excluding interest, late fees, costs, attorneys' fees, and similar charges, and whether the claimant is an assignee. The person who signs the notice of claim of lien may state that they have either read the notice of claim or heard and understood it, and believe it to be true and correct. This person also must state that the lien is not frivolous and is not clearly excessive.

Foreclosure

Prior to ordering foreclosure, the court must find that the lien claimant made reasonable efforts to recover amounts not yet paid from the prime residential contractor and/or residential subcontractor.

Informational Materials

Before issuing building permits for improvements to single-family residences of residential homeowners, permitting agencies must require residential homeowners to acknowledge personally and in writing that they received a copy of certain informational material about liens. Permitting agencies also must retain copies of such acknowledgments.

Legislative Task Force

A joint legislative task force is established to review laws governing certain construction liens and laws governing contractor registration, and to consider how such laws can better protect residential homeowners involved in the construction or remodeling of their homes. The task force must report its findings and recommendations to the Legislature by December 1, 2005.

Amended Bill Compared to Engrossed Second Substitute Bill:

Sections modifying construction lien and contractor registration laws are deleted, except for sections dealing with the contents of the notice of lien and foreclosure. Definitions of "prime residential contractor" and "residential subcontractor" are modified to limit the persons that may be held personally liable. Other sections are modified to establish personal liability only for lien claims involving violations of the fiduciary duties. A section is added to require

permitting agencies to require residential homeowners to acknowledge receipt of informational materials on liens before issuing building permits for certain projects. A section is added establishing a joint legislative task force to review construction lien and contractor registration laws.

Appropriation: None.

Fiscal Note: Requested for amended bill on April 1, 2005.

Effective Date of Amended Bill: The bill takes effect on July 1, 2006.

Testimony For: This is an all-American consumer protection bill. It is based on the core concept that, if you pay your bills, you shouldn't have to pay again. This core concept applies when you purchase a car, but not when you build or remodel a home. Ask yourself why homeowners should have to pay twice.

State law says that, when seeking payment, it is okay for subcontractors and suppliers to skip over the contractor, and lien the property of the homeowner.

This bill benefits subcontractors and suppliers, as well as homeowners. It specifies that, if homeowners pay their contractor, the contractor must pay the subcontractors and suppliers. It also specifies that any losses are split between the homeowner and the subcontractor or supplier. It requires homeowners obtaining building permits to complete an information sheet describing how to protect your property from liens.

The essence of contractor registration is to protect homeowners from bad actors. However, homeowners are in jeopardy from a limited number of contractors. Homeowners can seek to access contractor bonds. Contractors do not want to see their bonds impaired. If they lose their bonds, they cannot work in Washington.

In my case, the contractor walked off the job and filed a lien against my property. Even though the lien was frivolous, I still had to go to court. The devastation is more than financial.

Testimony Against: We support the bill's intent, which is to target the bad apples, but not its language, which impacts honest contractors. It takes all employees and makes them personally responsible. It would be impossible to get insurance to cover the personal assets of the contractor and all of the contractor's employees. The financial impact on people would encourage people to operate illegally.

The bill, like the lien laws, is very complicated. A person must be very astute to meet these requirements. Lien laws are already very stringent. Just because liens are filed does not mean liens will be perfected. There are already lots of ways for prudent buyers and credible contractors to avoid liens.

The bill requires distinct budgeting and accounting for each project. It essentially requires specific, auditable accounts for each project. Bookkeeping errors are subject to criminal penalties. These requirements would substantially raise consumer costs.

We also support the bill's concept, but oppose the bill in its current form. Sections 1 and 2 could be passed. Unregistered contractors and subcontractors cannot file liens. The requirement in section 3 that subcontractors and suppliers keep track of all liens filed in the previous three years, and report any problems to the Department could create credit reporting and other legal problems.

The bill is fundamentally flawed. When the old lien law was passed, the vote was unanimous. At that time, we wanted provisions establishing fiduciary duties, but did not get it. Ten states have laws establishing fiduciary duties and/or trust accounts.

The last thing that subcontractors and suppliers want to do is lien homeowners. There are no deadlines specifying how quickly, after filing liens on contractor bonds, subcontractors and suppliers would get paid. Contractor registration should include the names of all the directors, so that subcontractors, suppliers, and others know who is responsible.

Contractors, especially those who deal with residential homeowners, are in a tough business in which to be profitable. They need to build special relationships with homeowners.

The bill is not yet ready for full application, and contains internal conflicts. Sections 1 and 2 of the bill are workable, and will solve 85 to 90 percent of the problem.

Persons Testifying: (In support) Senator Fraser, prime sponsor; Patrick Woods and Pete Schmidt, Department of Labor and Industries; and Elizabeth Morse.

(Opposed) Brian Minnich, Building Industry Association of Washington; John Bratton, J.W. Bratton Design and Building; Gordon Gregg, City Builders; Bob Gee, Western Building Materials Association; Kerry Lawrence; Gary Smith, Independent Business Association; Debbie De Boer, Ruthanne Shay, and Janet Cole, National Association of Credit Managers; Larry Stevens, National Electrical Contractors Association and Mechanical Contractors Association; and Kathleen Collins, Sheet Metal and Air Conditioning Contractors of Western Washington.

Persons Signed In To Testify But Not Testifying: None.